

AR35



ANNUAL REPORT 1971

HEAD OFFICE:

Third Floor
703 Fifth Street S.W.,
Calgary 2, Alberta

DIRECTORS:

R. L. Borden, Calgary, Alberta
D. B. Bullock, Calgary, Alberta
W. C. Bumpers, Chicago, Illinois
W. H. Molle, Toronto, Ontario
Alexander Muirhead, Calgary, Alberta
John Thompson, Toronto, Ontario

**OFFICERS:**

W. H. Molle, President
J. R. Schmid, Executive Vice-President
and General Manager
Peter Floyd, Secretary

AUDITORS:

Peat, Marwick, Mitchell & Co.,
Calgary, Alberta

SOLICITORS:

McLaws & Co.
Calgary, Alberta

BANKERS:

The Bank of Montreal, Main Branch
Calgary, Alberta

REGISTRAR:

Montreal Trust Company,
at its offices:

Calgary, Alberta
Vancouver, B.C.
Toronto, Ontario
Montreal, Quebec

LISTING:

Toronto Stock Exchange

ANNUAL MEETING:

The Annual Meeting will be held at 10:00
a.m., Thursday, September 23, 1971 at the
Lake Louise Room, Calgary Inn, 4th Avenue
and 3rd Street S.W., Calgary, Alberta.

President's Report to Shareholders

A report was given to you in December 1970 and an Interim Report followed in February 1971. This report overlaps those reports and will therefore be limited in content.

Your present Management during the latter portion of the fiscal year reported herein, embarked on a program of consolidation and a careful examination of the notes being part of the Annual Reports will disclose the many and varied transactions to which the present Board of Directors gave its attention and on which action was taken.

In general, we have sought to limit or reduce items of operational cost and overhead to effect a balance between operating revenues and operating costs.

We are pleased to report we are approaching such a balance.

In addition, we have sought to realize upon and improve the security with respect to certain receivables. We are satisfied that substantial progress has been realized regarding efficiency in our operation.

With respect to the continuation of the exploration and development of your Company's properties we have appointed Mr. J. R. Schmid as Executive Vice-President and General Manager. Mr. Schmid, a Geologist by profession, brings to the Company some 20 years of broad experience in the oil industry.

Mr. Schmid is to be assisted by Mr. D. J. Peterson as Exploration Manager. The holder of an advanced degree in Geology, Mr. Peterson has spent 15 years in Canadian oil exploration for both major and independent companies.

An in depth study of your United Kingdom properties is nearing completion and it is expected that our exploration program respecting those properties will be formulated in accordance with the results of that study.

As you are aware, there has been a change of Management in your Company since the date of the last Annual General Meeting and the Company is now completing its corporate reorganization.

W. H. MOLLE
President

Consolidated Balance Sheet

March 31, 1971
(with comparative figures for 1970)

ASSETS

	<u>1971</u>	<u>1970</u>
Current assets:		
Cash	\$ —	14,519
Short-term deposits (Note 2)	610,000	—
Accounts receivable	60,724	60,310
Prepaid expenses	<u>2,481</u>	<u>4,573</u>
Total current assets	<u>673,205</u>	<u>79,402</u>
Notes receivable including accrued interest (Note 3)	<u>247,295</u>	<u>—</u>
Deferred accounts receivable	<u>21,240</u>	<u>27,683</u>
Property and equipment, at cost less depletion and depreciation (Note 4):		
Petroleum and natural gas properties	1,320,460	4,330,595
Less accumulated depletion	<u>560,435</u>	<u>493,907</u>
	<u>760,025</u>	<u>3,836,688</u>
Production and other equipment	429,709	911,726
Less accumulated depreciation	<u>276,302</u>	<u>406,339</u>
	<u>153,407</u>	<u>505,387</u>
Mineral properties	<u>52,511</u>	<u>—</u>
Net property and equipment	<u>965,943</u>	<u>4,342,075</u>
Other assets:		
Drilling and other deposits, at cost less amounts written off	42,756	42,756
Drilling rig held for sale—at cost less accumulated depreciation	32,572	—
Incorporation costs	5,401	5,401
Agreement by D. Bruce Bullock & Associates Ltd. to assume liability of bank loan from the Bank of Montreal — see contra-against which 1,541,700 shares of Pinnacle Petroleum Ltd. are pledged, less allowance for estimated deficiency in value of shares pledged \$2,103,135 (Note 5 (b))	1,002,000	1,203,112
Due from D. Bruce Bullock & Associates Ltd. less allowance for loss 1971—\$32,629	<u>—</u>	<u>32,629</u>
	<u>1,082,729</u>	<u>1,283,898</u>
	<u>\$2,990,412</u>	<u>5,733,058</u>

LIABILITIES

	<u>1971</u>	<u>1970</u>
Current liabilities:		
Cash on deposit less outstanding cheques	\$ 3,778	—
Bank loans	—	146,700
Accounts payable and accrued liabilities	72,212	673,553
Debentures payable	—	688,147
9¾% loan payable	—	140,000
Demand bank loan (\$2,600,000 U.S. funds) (Notes 5 and 6)	<u>2,626,000</u>	<u>—</u>
Total current liabilities	<u>2,701,990</u>	<u>1,648,400</u>
Bank loans, less current portion	<u>—</u>	<u>513,275</u>
Demand bank loan (2,600,000 U.S. funds)	<u>—</u>	<u>2,803,112</u>
Deferred gain on foreign exchange, arising on transfer of demand bank loan to current liabilities (Notes 5 and 6)	<u>177,112</u>	<u>—</u>
Deferred interest income (Note 3)	<u>22,294</u>	<u>—</u>
Shareholders' equity:		
Share capital (Note 7):		
Authorized 7,000,000 shares without nominal or par value		
Issued 5,380,895 shares	5,774,799	5,774,799
Deficit	<u>5,685,783</u>	<u>5,006,528</u>
	<u>89,016</u>	<u>768,271</u>

Commitments and contingencies (Note 8)

Approved on behalf of the Board:

"W. H. MOLLE", Director

"R. L. BORDEN", Director

<u><u>\$2,990,412</u></u>	<u><u>5,733,058</u></u>
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See accompanying notes.



PINNACLE PETROLEUMS LTD. AND SUBSIDIARY COMPANIES

Consolidated Statement of Earnings and Deficit

Year ended March 31, 1971
(with comparative figures for 1970)

	<u>1971</u>	<u>1970</u>
Revenue:		
Oil and gas, net	\$ 213,932	263,569
Interest and other income	75,453	30,330
	<u>289,385</u>	<u>293,899</u>
Expenses — net:		
Operating	101,118	174,922
General and administrative	256,171	281,913
Interest — long term	45,747	53,315
— other	4,042	117,914
Depreciation	57,807	125,124
Foreign exploration	25,547	—
Depletion	66,528	104,036
Write down in carrying value of petroleum and natural gas properties	—	1,960,000
Provision for doubtful accounts	34,863	—
Sundry	—	4,981
Expenses recovered	—	(22,662)
	<u>591,823</u>	<u>2,799,543</u>
Net loss before extraordinary items	302,438	2,505,644
Extraordinary items:		
Provision for estimated deficiency under an agreement (Note 5 (b))	503,135	1,600,000
Deduct gain on sale of production equipment	126,318	—
	<u>376,817</u>	<u>1,600,000</u>
Net loss	679,255	4,105,644
Deficit, beginning of year	5,006,528	900,884
Deficit, end of year	<u>\$5,685,783</u>	<u>5,006,528</u>
Loss per share:		
Loss before extraordinary items	\$ 0.06	0.46
Net loss	<u>\$ 0.13</u>	<u>0.76</u>

See accompanying notes.

Subject to the accompanying report of
Peat, Marwick, Mitchell & Co., Chartered Accountants,
dated June 10, 1971.

Consolidated Statement of Source and Application of Funds

Year ended March 31, 1971
(with comparative figures for 1970)

	<u>1971</u>	<u>1970</u>
Source of funds:		
Proceeds from sales of shares of capital stock	\$ —	2,656,071
Net proceeds from sale of petroleum and natural gas properties and equipment	3,788,754	352,491
Increase in bank loans — net	—	127,383
Sundry	6,443	6,524
Total funds provided	<u>3,795,197</u>	<u>3,142,469</u>
Use of funds:		
Net loss for the year	679,255	4,105,644
Deduct non-cash items, net:		
Provision on estimated deficiency under an agreement (Note 5 (b))	503,135	1,600,000
Depletion	66,528	104,036
Depreciation	57,807	125,124
Write down in carrying value of petroleum and natural gas properties	—	1,960,000
Provision for doubtful accounts	32,629	—
Other	—	3,092
Gain on sale of production equipment	(126,318)	—
	<u>533,781</u>	<u>3,792,252</u>
Funds applied to operations	145,474	313,392
Advance on behalf of D. Bruce Bullock & Associates Ltd.	302,023	32,629
Purchase of property and equipment	443,212	740,235
Reduction of bank loans, net of current portion	513,275	—
Demand bank loan transferred to current liabilities	2,626,000	—
Acquisition of subsidiary companies for shares issued including agreement to assume bank loan	—	5,369,934
Less bank loan to be assumed	—	2,803,112
	<u>—</u>	<u>2,566,822</u>
Note receivable	225,000	—
Working capital deficiencies of subsidiary companies at date of acquisition	—	174,581
Total funds applied	<u>4,254,984</u>	<u>3,827,659</u>
Increase in working capital deficiency	<u>\$ 459,787</u>	<u>685,190</u>

See accompanying notes.

Subject to the accompanying report of
Peat, Marwick, Mitchell & Co., Chartered Accountants,
dated June 10, 1971.



Notes to Consolidated Financial Statements

March 31, 1971

1. Principles of Consolidation:

The consolidated financial statements include the accounts of Pinnacle Petroleum Ltd. and those of its wholly-owned subsidiary companies, Bal-donnell Oil & Gas Ltd., Midalta Oil Company Limited and Grizzly Petroleum Limited and its wholly owned subsidiary Grizzly Petroleum (U.K.) Limited.

The excess of the purchase price of the shares of the subsidiaries over their underlying net book values at dates of acquisition amounting to \$2,567,698 has, on consolidation, been added to petroleum and natural gas properties and is being depleted on consolidation.

The companies follow the "full cost" method of accounting wherein all costs and expenses of exploring for and developing oil and natural gas reserves are capitalized and depleted over the production lives of the properties on a composite unit of production basis. In 1970 the company wrote down the carrying value of its petroleum and natural gas properties \$1,960,000 (See also Note 4).

2. Short-Term Deposits:

The company has pledged with its bankers a \$25,000 deposit receipt as collateral pending clean up of a well site. No provision has been made in the accompanying financial statements for such clean-up costs.

3. Note Receivable:

In July, 1970 the company advanced, under a demand promissory note, \$225,000 to another company with interest payable at 14%. At March 31, 1971 this note was in default and no payments had been received on principal or interest. Accordingly, interest earned to March 31, 1971 has been shown as deferred income on the consolidated balance sheet rather than being shown as income earned in the consolidated statement of earnings and deficit pending final realization. (See also Note 10 (a)).

4. Petroleum and Natural Gas Properties:

On June 12, 1970 certain petroleum and natural gas properties and production equipment of the company were sold for a net cash consideration of \$3,785,000. The properties sold represented approximately 93% of the total proven oil and natural gas reserves of the companies as at that date. The portion of the proceeds applicable to production equipment resulted in a gain of \$126,318.

5. Other Assets:

- (a) On June 9, 1969, prior to becoming a wholly-owned subsidiary company, Midalta Oil Company Limited acquired from a certain shareholder 1,913,000 shares of Pinnacle Petroleum Ltd. Payment for these shares was made from the proceeds of a demand bank loan from the Bank of Montreal on August 9, 1969 totalling \$2,600,000 (U.S. funds). (\$2,803,112 Canadian funds as at that date). As part of the security for such bank loan 1,541,700 of these shares were pledged to the Bank of Montreal.

Greyhound Leasing & Financial Corporation entered into an agreement with the Bank of Montreal wherein Greyhound agreed to pay to the Bank on or before June 9, 1971 an amount equal to the then outstanding principal balance of the amount due to the Bank of Montreal by Midalta Oil Company Limited including accrued interest thereon. In addition, upon the fulfilment by Greyhound of its obligation to make such payment and as a condition of such payment, Greyhound will take over the Bank's position, together with all of the Bank's rights, title, interest and security in such loan, which includes the 1,541,700 shares of Pinnacle Petroleum Ltd. referred to above. (See note 10 (b)).

In consideration of Greyhound Leasing & Financial Corporation entering into the agreement referred to above Greyhound Leasing & Financial of Canada Ltd. received 171,300 shares of Pinnacle Petroleum Ltd. from Midalta Oil Company Limited.

- (b) Under an agreement dated August 18, 1969 Midalta Oil Company Limited sold to D. Bruce Bullock & Associates Ltd. (all of the issued and outstanding shares of which were owned by Messrs. D. B. Bullock, H. S. Rhodes and A. Muirhead) the remaining 1,742,700 shares of Pinnacle Petroleum Ltd. owned by Midalta Oil Company Limited subject to all liens, encumbrances and pledges, including the pledge of 1,541,700 shares thereof to the Bank of Montreal, referred to above. In consideration of such sale D. Bruce Bullock & Associates Ltd. agreed to assume the obligations, both present and contingent, including the demand loan from the Bank of Montreal, arising out of the purchase of such shares on June 9, 1969, referred to above.

On September 28, 1970 Midalta Oil Company Limited advanced \$302,023 on behalf of D. Bruce Bullock & Associates Ltd. in connection with interest and other obligations under the above agreement. These transactions have been recorded in the accompanying balance sheet under the heading "Other Assets" in the amount of \$3,105,135 (prior to the allowance hereunder referred to) including the advance of \$302,023. An accumulated allowance of \$2,103,135 has been provided in the accompanying financial statements being the estimated deficiency in the market value of the 1,541,700 shares of the company pledged to the Bank of Montreal. (See also Note 10 (b)). This estimated deficiency has been calculated based upon the price per share at the close of trading on the Toronto Stock Exchange on June 10, 1971 and on the assumption that the shares so pledged to the Bank of Montreal together with other shares of Pinnacle Petroleum Ltd. owned by Mr. D. B. Bullock (which together, under agreements between the Bank of Montreal, D. B. Bullock, Greyhound Leasing & Financial Corporation and certain other parties, comprise effective control of the company) could be sold en bloc and would, in the opinion of management, realize not less than the closing market price per share at June 10, 1971 being approximately 65 cents per share.

6. Demand Bank Loan:

The bank loan is payable on demand; however, under the agreed terms of repayment, this loan is due June 9, 1971 (See also notes 5 and 10 (b)). The interest payable on this demand bank loan is at the rate obtained by adding to the minimum New York prime rate for United States dollars an additional rate of 2½% per annum.

7. Stock Options:

The following stock options were outstanding as at March 31, 1971. (See also Note 10 (c)).

Number of Shares	Option Price	Exercisable	Termination Date
2,000	\$1.35	1/5 per annum, cumulative	December 31, 1976 or termination of employment.
12,500	1.40	1/5 per annum, cumulative, commencing October 1, 1970	September 15, 1979 or termination of employment.
2,500	3.23	1/5 per annum, cumulative	December 31, 1976 or termination of employment.
<u>17,000</u>			

During the year options for 106,000 shares were cancelled as a result of the termination of employment and a management contract.

8. Commitments and contingencies:

Under the terms of an agreement between Pinnacle Petroleum Ltd. and D. Bruce Bullock & Associates Ltd., management services are provided to Pinnacle Petroleum Ltd. for a three year term from August 18, 1969 at the rate of \$5,000 per month. In February, 1971 this contract was terminated.

Under the terms of a lease of office premises, Pinnacle Petroleum Ltd. is obligated to pay rentals aggregating \$20,220 per annum for a three year term from August 1, 1969.

9. Income Taxes:

For income tax purposes the companies are entitled to claim drilling, exploration and lease acquisition costs and capital cost allowances (depreciation for tax purposes) in amounts which may exceed the related depletion and depreciation provisions reflected in the accounts. For 1971 the companies do not intend to claim excess capital allowances but will claim the other specified deductions in amounts sufficient to eliminate taxable incomes, and expenditures remaining to be carried forward and applied against future taxable income are as follows:

Drilling, exploration and lease acquisition costs	\$ 2,107,317
Undepreciated capital cost	155,032

10. Subsequent Events:

- (a) Subsequent to March 31, 1971 certain legal action has been taken to more fully secure the note receivable and to arrange repayment. Under an agreement dated March 31, 1971 the company has amended the terms of the note whereby the interest rate is reduced from 14% to 8% per annum and will be payable in six monthly installments commencing November 1, 1971. In addition the company, under the terms of the agreement has obtained additional specific and collateral security for the repayment of this indebtedness.
- (b) On June 9, 1971 Greyhound Leasing & Financing Corporation took over the Bank of Montreal position as set out in Note 5 (a). The indebtedness outstanding under the agreement as at June 9, 1971 in the amount of 2,600,000 U.S. funds is due to Greyhound on or before December 31, 1971 including interest.
- (c) Subsequent to March 31, 1971 stock option of 17,000 shares were cancelled upon termination of employment.

11. Remuneration:

The aggregate remuneration paid to directors and senior officers during the year was \$52,410 which includes the amounts paid under the contract referred to in Note 8.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Pinnacle Petroleums Ltd. and subsidiary companies as of March 31, 1971 and the consolidated statements of earnings and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances except in regards to the valuation of the amount carried in the accompanying balance sheet under the heading "Other Assets" in the amount of \$1,002,000.

Under an agreement dated August 18, 1969 D. Bruce Bullock & Associates Ltd. agreed to assume a bank loan. At March 31, 1971 and at the date of our report a subsidiary company still remains directly liable for this loan. As referred to in note 5 (a) the Bank of Montreal (as at June 9, 1971 Greyhound Leasing and Financial Corporation, see Note 10 (b)) holds certain shares as security, for this indebtedness representing approximately 28% of the outstanding shares of Pinnacle Petroleums Ltd. Because of the present market value of these shares the Company has provided, as described in note 5 (b), an allowance of \$2,103,135 in connection with this transaction.

Due to the number of shares involved the amount of \$1,002,000 may not be indicative of final realization.

In our opinion, subject to the valuation referred to in the preceding paragraph, these consolidated financial statements present fairly the financial position of the Company and its subsidiary companies at March 31, 1971 and the results of their operations and the source and application of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
June 10, 1971

PEAT, MARWICK, MITCHELL & Co.
Chartered Accountants

